

OLC 74-2487
2 December 1974

MEMORANDUM FOR THE RECORD

SUBJECT: Action Taken with Respect to Phasing Out of the Federal
Income Tax Exemption for Foreign Areas and Cost-of-
Living Allowances Presently Granted Pursuant to
26 U. S. C. 912

1. Following the alert we received from a private law firm on Monday, 25 November 1974, the following external Agency sources were contacted. In every case so far it was clear that these sources were completely surprised by the amendment and were unaware of the amendment before our initial alert on Monday.

(a) OMB -- George Gilbert, Ralph Malvik, Legislative Reference Service and Jay Breneman, their expert on taxes. As a result, Hilda Schrieber, OMB, contacted State Department and Jay Breneman will be contacting the Treasury Department and let us know the results.

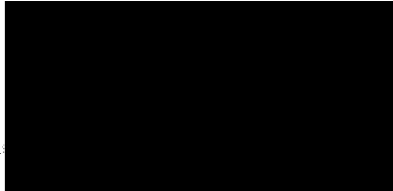
(b) State Department -- Robert Hull, Personnel, Bob Lamb, SA to Secretary for Administration and Kempton Jenkins, Congressional Relations. State is today seeing Representatives Elford Cederberg (R., Mich.), Wayne Hays (D., Ohio), and John Slack (D., W. Va.) for advice on what to do and Jenkins will let us know the results.

2. At this reading the prospects for Senate passage of the tax bill, in which the amendment is lodged (H. R. 17488), are dim in view of the provisions relating to oil depletion allowances, etc. However, there is a good chance that part, if not all of the bill, will be approved by the House.

3. Although there are sound reasons for exempting Governmental allowances from taxation, this year, more than most, does not appear to o propitious for focusing attention on the fact that Government employees serving abroad ("in luxurious places") are living it "high off the hog" with tax free allowances. The recommended course of action would be to: (1) walk softly and attempt to get the provision struck in Senate Committee (Finance); (2) let State Department take the lead since they have overall responsibility for most foreign area allowances; and (3) even if the overall bill is in trouble it would still be useful to deal with the issue -- a similar amendment could be appended to other legislation (with the same lack of hearings and consideration which led to its insertion in H. R. 17488), or similar legislation could be introduced in the 94th Congress, and dealing with the issue now may assure that we are not faced with another fait accompli out of committee in the 94th Congress.

4. Course of Action: It is recommended that beyond alerting our committees to this potential problem, getting their advice, and pushing the various agencies in the Executive Branch for an Administration position, as we have up to now, we do nothing at least until Kempton Jenkins reports back on State's soundings on the House and Jay Breneman's contacts with Treasury.

STATINTL


Deputy Legislative Counsel

Distribution:

Original - Subject

1 - DDA

1 - OGC

1 - OLC Chrono

OLC:LLM:bao (3 Dec 74) (4151/9227)

25 November 1974

100-74-2433

MEMORANDUM FOR THE RECORD

SUBJECT: HR 17488 (Tax Reform)

1. Pete Singleton, Minority Clerk of the House Ways and Means Committee, told me today that this bill, which is the Committee's bill, was ordered reported on 21 November and probably will be reported at midnight tomorrow. It is part of a larger tax reform package which the Committee has abridged for introduction this session. The bill includes sections on the treatment of foreign income and allowances and on oil and gas depletion allowances and oil and gas windfall profits. It provides for a phaseout of all of them, and as a result can expect very hard going in the Senate. There is no Senate bill at this time.

2. This bill would phase out the Section 911 exemption of foreign earned income (non-Governmental) and the Section 912 exemption of allowances paid to Government employees abroad, both to be phased out in a four-year period beginning 1 January 1975, resulting in no exemption in the tax year 1978. The phaseout would be 25 percent of the Government employee allowances in 1975; 50 percent in 1976; 75 percent in 1977 and 100 percent in 1978.

3. The Section 911 phaseout was discussed at public hearings in 1973, but the Section 912 phaseout was inserted by the staff of the Joint Committee of Internal Revenue Taxation this year, and not previously discussed. Only the Department of State appeared in opposition to the Section 912 amendment, and apparently, they did not do a very good job. This bill is not going anywhere this session, and in view of the problems it will face in the Senate from oil and gas industry supporters, that would appear to be the place to mount the counterattack. It is interesting to note that the Section 912 amendments were apparently a complete surprise to everybody. Joe McGowan, Director of the Office of International Operations, IRS, was not aware of them until after the fact.

STATINTL

Deputy General Counsel

cc: OLC

his (2), 1 States to withhold income tax upon such remuneration;
2 or".

c) (re- 3 (O) Section 6012 (c) (relating to certain in-
case of 4 come earned abroad or from sale of residence) is
es) is 5 amended—

ning of 6 (i) by striking out "Earned Abroad or"
7 from the subsection heading, and
8 (ii) by striking out "by individual" and
9 all that follows down through "United States".

10 (P) Subparagraph (B) (iii) of section 6091
11 (b) (1) (relating to place for filing returns of
12 persons other than corporations) is amended—

13 (i) by striking out "section 911 (relating
14 to earned income from sources without the
15 United States)," and
16 (ii) by striking out the comma immedi-
17 ately preceding "or section 933".

18 (b) AMENDMENTS TO SECTION 912.—

19 (1) PHASE OUT OF SECTION 912.—Section 912
20 (relating to exemption for certain allowances) is
21 amended by adding at the end thereof the following new
22 sentence:

1 "In the case of a taxable year beginning after December 31,
2 1974, and before January 1, 1978, the amount of the items
3 excludable from gross income under this section (deter-
4 mined without regard to this sentence) shall be reduced by
5 the percentage reduction specified in the following table:

"For a taxable year beginning in:	The percentage re- duction shall be
1975 -----	25
1976 -----	50
1977 -----	75."

6 (2) REPEAL OF SECTION 912.—Section 912 (re-
7 lating to exemption for certain allowances) is hereby
8 repealed.

9 (3) CONFORMING AMENDMENTS.—

10 (A) Part III of subchapter N of chapter 1 is
11 amended by striking out the heading and table of
12 sections for subpart B.

13 (B) The table of subparts for such part III is
14 amended by striking out the item relating to sub-
15 part B.

16 (c) DEDUCTION FOR CERTAIN TUITION EXPENSES
17 OF DEPENDENTS OF TAXPAYERS EMPLOYED OUTSIDE THE
18 UNITED STATES.—

19 (1) IN GENERAL.—Part VII of subchapter B of
20 chapter 1 (relating to additional itemized deductions
21 for individuals) is amended by redesignating section
22 220 as section 221 and by inserting after section 219
23 the following new section:

Ch. 1

21

INCOME FROM OUTSIDE U. S. 26 § 912

d v. Riddell, C.A.

findings that salary was received in United States from an American firm in New York. Id.

principle existed, it could not be enforced so as to interfere with or impair exclusive and nondelegable powers of executive and legislative departments with respect to foreign and military policies of nation. Farmer v. Rountree, D.C.Tenn.1956, 149 F.Supp. 327, affirmed 252 F.2d 490, certiorari denied 78 S.Ct. 1150, 357 U.S. 906, 2 L.Ed.2d 1156, rehearing denied 79 S.Ct. 14, 358 U.S. 858, 3 L.Ed.2d 92.

International law

There is no principle of international law operating to relieve citizens from tax obligations and liabilities under laws of their country, or imposing on them individual responsibility for loss of tax revenue; but even if such

912. Exemption for certain allowances

Following items shall not be included in gross income, and shall be exempt from taxation under this subtitle:

(1) Foreign areas allowances.—In the case of civilian officers and employees of the Government of the United States, amounts received as allowances or otherwise (but not amounts received as post differentials) under—

(A) title IX of the Foreign Service Act of 1946, as amended (22 U.S.C., sec. 1131 and following),

(B) section 4 of the Central Intelligence Agency Act of 1949, as amended (50 U.S.C., sec. 403e),

(C) title II of the Overseas Differentials and Allowances Act, or

(D) subsection (e) or (f) of the first section of the Administrative Expenses Act of 1946, as amended, or section 22 of such Act.

(2) Cost-of-living allowances.—In the case of civilian officers and employees of the Government of the United States stationed outside the continental United States (other than Alaska), amounts (other than amounts received under title II of the Overseas Differentials and Allowances Act) received as cost-of-living allowances in accordance with regulations approved by the President.

(3) Peace Corps allowances.—In the case of an individual who is a volunteer or volunteer leader within the meaning of the Peace Corps Act and members of his family, amounts received as allowances under section 5 or 6 of the Peace Corps Act other than amounts received as—

(A) termination payments under section 5(c) or section 6 of such Act,

(B) leave allowances,

(C) if such individual is a volunteer leader training in the United States, allowances to members of his family, and

(D) such portion of living allowances as the President may determine under the Peace Corps Act as constituting compensation.

11-221-1050-24

Note 22

tion of the issue of his foreign residence and exemption from income taxes because fees were earned as an international lawyer while the respondent was a bona fide resident of Germany. Application of Carroll, D.C.N.Y.1957, 149 F.Supp. 634, affirmed 246 F.2d 702, certiorari denied 78 S.Ct. 85, 335 U.S. 857, 2 L.Ed.2d 64.

23. Burden of proof

Taxpayer claiming that income was exempt from income taxes in United States, on ground that he was a resident of foreign country had burden of proof. See *Levy v. C. I. R.*, C.A.2, 1961, 156 F.2d 541.

A taxpayer's executor seeking review of Commissioner's determination of income tax deficiency had burden of proving that income was received for personal services performed without the United States during taxable period. *C. I. R. v. Fiske's Estate*, C.C.A.1942, 128 F.2d 457, certiorari denied 63 S.Ct. 63, 317 U.S. 635, 57 L.Ed. 512.

Taxpayer claiming that he was an employee or partner with guaranteed salary, rather than simple partner, so as to be entitled to income tax exclusion for earnings abroad, had burden of proof. *Poster v. U. S.*, D.C.N.Y.1963, 221 F.Supp. 291, affirmed 329 F.2d 717.

24. Evidence

An American citizen who lived and practiced law in Germany for most of the time from 1946 to 1954 could be examined by Internal Revenue Service as to kind of legal work which he did in Germany, for when, how much and on what basis he was paid, how he was paid and when, on theory that such matters were relevant to question of residence, and the Internal Revenue Service was not required to introduce evidence on the residence issue as a prerequisite to such investigation. Application of *U. S.*, C.A.N.Y.1957, 216 F.2d 762, certiorari denied 78 S.Ct. 85, 335 U.S. 857, 2 L.Ed.2d 64.

25. Questions of fact

Whether taxpayer was a partner or an employee, for purpose of determining right to income tax exclusion for earnings abroad, was question of fact. *Poster v. U. S.*, D.C.N.Y.1963, 221 F.Supp. 291, affirmed 329 F.2d 717.

26. Waiver

Where taxpayer failed to raise the issue of whether both he and his wife were entitled to the full exclusion permitted by this section before the Commissioner he was not entitled to

eral income taxes. *Levy v. C. I. R.*, Cal.1962, 309 F.2d 51.

27. Review

Tax Court's fact findings concerning whether taxpayer was a bona fide resident of foreign country that their earned income from sources without United States were not clearly erroneous. *Matthew, C.A.Pa.1961, 337 F.2d 1001*, certiorari denied 82 S.Ct. 1024, 364 U.S. 13, 1 L.Ed.2d 962.

Conclusion of Tax Court that taxpayer was bona fide resident of foreign country for taxable year with exclusion exempting from foreign source amounts received by such taxpayer from sources without United States was question of law or at least mixed question of law and fact, and is subject to review by Court of Appeals, which may substitute its judgment for that of the Court. *Sechurn v. C. I. R.*, 300 F.2d 34.

Where Court of Appeals reversed the Court's decision contrary to Commissioner's finding that taxpayer was a resident of foreign country for the year, and was without personal income from sources without United States, the law, Circuit Court of Appeals was compelled to reverse the decision. *Swart, C.C.A.4, 1946, 153 F.2d 1001*, certiorari denied 67 S.Ct. 191, 322 U.S. 1, 1 L.Ed. 685.

Question whether taxpayer was a bona fide nonresident of the United States for more than six months during the year, so that their income from sources outside the United States was exempt from taxation under this section was a question of law, and the Appeals was not required to follow the decision of the Tax Court. 11

The conclusion of Board of Tax Appeals that taxpayer was a resident of the United States for the year, notwithstanding the fact that he was not paid him as compensation for his services, and hence was not exempt from income tax, was not a question of fact, and hence was not subject to review by the Court of Appeals. *U. S. v. Fiske's Estate*, C.C.A.1942, 128 F.2d 457, certiorari denied 63 S.Ct. 63, 317 U.S. 635, 57 L.Ed. 512.

In determining whether salary was received by an American citizen who was exempt from income tax because salary was a part of his services rendered without the United States, Court of Appeals could not

that salary was received in principle existed, it could not be enforced so as to interfere with or impair exclusive and nondelegable powers of executive and legislative departments with respect to foreign and military policies of nation. *Farmer v. Rountree*, D.C.Tenn.1956, 149 F.Supp. 327, affirmed 252 F.2d 490, certiorari denied 78 S.Ct. 1150, 357 U.S. 904, 2 L.Ed.2d 1156, rehearing denied 79 S.Ct. 14, 358 U.S. 858, 3 L.Ed.2d 82.

Individual law

112. Exemption for certain allowances

Following items shall not be included in gross income, and exempt from taxation under this subtitle:

(1) Foreign areas allowances.—In the case of civilian officials and employees of the Government (but not amounts received as post differentials) under—

(A) title IX of the Foreign Service Act of 1946, as amended (22 U.S.C., sec. 1131 and following),

(B) section 4 of the Central Intelligence Agency Act of 1949, as amended (50 U.S.C., sec. 403e),

(C) title II of the Overseas Differentials and Allowances Act, or

(D) subsection (e) or (f) of the first section of the Administrative Expenses Act of 1946, as amended, or section 22 of such Act.

(1) Cost-of-living allowances.—In the case of civilian officials or employees of the Government of the United States stationed outside the continental United States (other than Alaska), amounts (other than amounts received under title II of the Overseas Differentials and Allowances Act) received as cost-of-living allowances in accordance with regulations approved by the President.

(1) Peace Corps allowances.—In the case of an individual who is a volunteer or volunteer leader within the meaning of the Peace Corps Act and members of his family, amounts received as allowances under section 5 or 6 of the Peace Corps Act other than amounts received as—

(A) termination payments under section 5(c) or section 6(1) of such Act,

(B) leave allowances,

(C) if such individual is a volunteer leader training in the United States, allowances to members of his family, and

(D) such portion of living allowances as the President may determine under the Peace Corps Act as constituting